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IN THE

Supreme Court of the United States

OCTOBER TERM, 1932.

No. 965

LILY CLAPIER,

Petitioner
(Appellant Below),

vs.

RUDOLPH B. FLERSHEM, CHARLES O. CORNELL, JOHN H. WATERS and FRANK B. CAHN, as the Reorganization Committee constituted under the Plan and Agreement dated February 11, 1931, for the Reorganization of National Radiator Corporation, and NATIONAL RADIATOR CORPORATION,

Respondents
(Appellees Below).

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

DAVID M. PALLEY,
of New York, N. Y.

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To the Honorable CHARLES E. HUGHES, the Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

LILY CLAPIER, the above named petitioner, respectfully prays that a writ of certiorari issue to review the

decree of the United States Circuit Court of Appeals for the Third Circuit, entered on March 24th, 1933, affirming the decree (R., 82) of the United States District Court for the Western District of Pennsylvania, dated the 31st day of May, 1932, and made by Judge Gibson, dismissing the petitioner's ancillary bill in the nature of a bill of review on the grounds that it does not state a good and sufficient cause of action and that it is without equity.

Statement.

On or about October 9th, 1931, the respondents, Rudolph B. Flershem, Charles O. Cornell, John H. Waters and Frank B. Cahn, as the Reorganization Committee constituted under the Plan and Agreement dated February 11, 1931, for the Reorganization of National Radiator Corporation, filed a bill of complaint against the respondent, National Radiator Corporation, in which they prayed for the appointment of receivers of said corporation, the sale of its assets and the distribution of the proceeds (R., 9). The National Radiator Corporation appeared in that cause, admitted the allegations of the bill and joined in the prayer for relief (R., 68). Upon that bill and answer, a decree was entered, receivers were appointed (R., 71) and creditors were enjoined from enforcing payment of their claims.

On December 11th, 1931 (R., 2), the petitioner who was the owner of $11,000.00 principal amount of the company's debentures and was not a party to that cause, filed an ancillary bill in the nature of a bill of review, in which she prayed that the decree in the primary cause be vacated and the bill dismissed on the ground that it is apparent upon the face of that bill that the court did not have jurisdiction of the subject matter of the cause and that no cause of action for equitable relief or cognizable by a court of equity was set forth.

The primary cause was not brought on the ground that the defendant corporation was insolvent or in imminence of insolvency. Although the bill declares that intervention by the court was necessary to prevent "a multiplicity of suits, a race of diligence, wasteful strife and controversy" (R., 17), it is apparent from a perusal of that bill and the exhibits annexed thereto that on October 9th, 1931, the National Radiator Corporation was solvent and amply able to pay in full, in cash, every debt presently due and maturing. It is also apparent that jurisdiction was invoked solely for the purpose of effectuating a reorganization of the company in order to scale its funded debt and to coerce non-assenting debentureholders into subjection to the plan or else to wipe them out.

The National Radiator Corporation, a Delaware corporation, was engaged in the business of manufacturing and selling heating appliances, boilers and radiators (R., 10). It was formed in August, 1927, by a merger of six companies (R., 49), and on December 31st, 1930, it had outstanding 58,646 shares of $7.00 cumulative preferred stock, of no par value, and 272,708 shares of common stock, also of no par value, which at that time were carried on the books at $8,134,643.01 (R., 52).

On or about August 30th, 1927, the company authorized an issue of $16,000,000.00 principal amount, 6½%, Sinking Fund Gold Debentures, and pursuant to that authority, there was issued $12,000,000.00 of said debentures which, on October 9th, 1931, had been reduced to $10,705,000.00 (R., 12). The debentures mature August 1st, 1947, bear interest at the rate of 6½% per annum, payable semi-annually on the first days of February and August in each year. The terms and provisions governing their issue and the appurtenant interest coupons, as well as the rights and remedies of the holders, are set forth in an Indenture (Schedule A, annexed to the original bill, R., 22-47) made and executed between the

National Radiator Corporation and the Bankers Trust Company, a New York corporation, as Trustee (R., 11).

On February 1st, 1931, the National Radiator Corporation refused to pay the installment of interest which then became due on its outstanding debentures (R., 48-49).

On February 1st, 1931, the National Radiator Corporation was solvent and liquid and able to discharge in full, in cash, every obligation then due and payable. In the Plan and Agreement (Schedule B, annexed to the original bill, R., 48-67) is a financial statement of the company's condition as of December 31st, 1930, just one month before (R., 51-52). It discloses that on that day the company had a net worth of $8,134,643.01; its assets were $19,434,548.08; its liabilities, including the outstanding debentures, were $11,299,905.07.

Especially noteworthy and impressive is the statement of its current assets and current liabilities. On December 31st the quick current assets of the company were $5,054,007.30 and of that $1,701,899.94 was in cash. Its current liabilities at that time were $491,895.72 (only $46,787.60 was presently due, R., 52) and included therein was $293,339.58 accrued interest upon its outstanding debentures. The ratio of cash to current liabilities was more than 3½ to 1. The ratio of current assets to current liabilities was more than 10 to 1.

On February 1st, 1931, another month's interest amounting to $53,580.00 had accrued upon its debentures and the liabilities presently due and maturing were thereby increased to $545,475.72. It is obvious, however, that on February 1st, 1931, the company could have paid all its current debts including the interest on the debentures out of cash alone and there would still have remained in cash $1,200,000.00, and none of the other current assets would have been affected.

The company was manifestly solvent and liquid. Its refusal to pay the interest upon the outstanding debentures was unconscionable.

The explanation, given by the parties to that cause, for the refusal to pay the interest on February 1st, 1931, is that the cash was needed as working capital for an anticipated increase of business, for the carrying of larger inventories and for the purchase of new machinery and equipment, in order to maintain the corporation's competitive position in the industry (R., 53). A further explanation was that the outlook for the immediate future was obscure (R., 53).

Not only was the payment of interest omitted, but for the reasons given the company had decided to reorganize in order to scale its funded debt and thus drastically reduce its fixed charges (R., 53). On February 11th, 1931, ten days after the default, a reorganization committee appointed by the company promulgated a plan of reorganization (R., 54) and appointed the Bankers Trust Company, the Trustee of the debentures, depositary under the plan (R., 62).

The plan is all in the interest of the company, discriminates between debentureholders and other creditors of equal rank, contains no provision for any new capital and makes no provision for non-assenting debentureholders.

The plan contemplates the organization of a new corporation to which is to be transferred all of the assets of the old corporation, including cash (R., 55). The capital structure of the new corporation is to be as follows (R., 56):

	Authorized	*To Be Presently Outstanding*
15-Year 5% Debentures	$5,500,000	$5,358,000
$7 Preferred Stock (no par value)	55,000 shares	53,580 shares
Common Stock (no par value)	400,000 shares	272,966 shares

The new debentures bear interest at the rate of 5% per annum which, however, is payable only out of income (R., 57).

Merchandise and service creditors are to be paid in full by the new company unless they shall have been previously paid by the old (R., 56).

Debentureholders, however, are to receive for each $1,000.00 principal amount of old debentures $500.00 principal amount of new debentures, 5 shares of new preferred stock and 20 shares of new common stock (R., 61).

The holders of present preferred stock are to receive, share for share, common stock of the new corporation. Holders of the present common stock are to receive stock warrants of the new company in the ratio of 1 to 3, namely, one stock warrant of the new company for each three shares of the old, **upon payment to the Reorganization Committee** of $1.00 for each warrant issued (R., 61). Holders of the warrants are entitled to purchase, **on or before July 1st, 1941,** shares of common stock in the new company upon payment of $20.00 per share (R., 60).

There is no provision for any assessment upon the preferred stockholders and the holders of the stock warrants have until the 1st day of July, 1941, to decide whether to exercise their option or not.

On August 1st, 1931, the company also refused to pay the installment of interest which then became due upon the outstanding debentures (R., 14). A large number of debentureholders refused to assent to the plan, demanded payment of their interest and threatened suit when such payment was refused (R., 16). Thereupon, the bill in the primary cause was filed by the Reorganization Committee; the National Radiator Corporation appeared and consented to the decree, and the decree appointing receivers and enjoining creditors was entered (R., 71).

There is no allegation anywhere in that bill or in the answer that the corporation was then unable to pay its debts, current and maturing in regular course; nor is there any allegation that the company was insolvent or in imminence of insolvency.

There is nothing in the record to show that on October 9th, 1931, the financial condition of the company was substantially different from what it was on February 1st, 1931. The only statement of the company's financial condition submitted to the court, at the time of the making of the decree, was the statement of December 31st, 1930 (R., 51-52), which is contained in the Plan and Agreement annexed to the bill of complaint, and in the absence of proof to the contrary, the only inference that can be drawn is that it substantially represents the condition of the company at the time that it was submitted.

Of course, there must be added to the debts of the company the installment of interest on its outstanding debentures, amounting to $374,675.00, which became due on August 1st, 1931, and which was not paid. The current debts of the company were thereby increased to $920,150.72. Even then there was more than enough cash to pay and discharge in full the current debts, including the interest upon the debentures, without affecting any of the other current assets.

It was apparent to the court at the time of the making of the decree that the National Radiator Corporation was not insolvent or in imminence of insolvency. The principal of the debentures was not due until August 1st, 1947, sixteen years later; and the corporation had ample funds with which to pay and discharge in full, in cash, all its debts presently due and payable, including the arrears of interest upon the debentures.

Nor is there any pretense on the part of the respondents that the company was insolvent or in imminence of insolvency. The objection was only to the payment

of the accrued interest upon the debentures (R., 16), but not to the payment of the other debts of the corporation which were to be assumed by the new company if not previously paid by the old (R., 56). The respondents implicitly concede the solvency of the corporation and expressly admit that the suit was instituted to prevent creditors who refused to assent to the plan of reorganization, from collecting the interest upon their debentures (R., 16).

The Indenture expressly provides that in the event of a sale by the company of its property as an entirety, the obligations of the debentures shall be assumed by the new company (R., 45-47). It is therefore obvious that the suit was instituted to compass the transfer of the property and business of the National Radiator Corporation free from those obligations. As stated by Judge Gibson in his opinion (R., 80):

> "* * * The bill was specifically stated to be for the purpose of bringing about a reorganization of the defendant company * * *."

We have thus set forth briefly the state of the record in the primary cause at the time of the filing of the petitioner's ancillary bill.

The appeal in this cause was heard by the Circuit Court of Appeals for the Third Circuit at the same time as the other appeals from decrees in the primary cause and the Circuit Court of Appeals rendered a single opinion, per Woolley, C. J. In its opinion the Circuit Court of Appeals said:

> "* * * It is pertinent to note the bill did not say the corporation was insolvent. That, in effect, was a tacit admission or declaration of its solvency. The corporation, by its answer, admitted the truth of all allegations of the bill.

"Concededly, the corporation was solvent in the sense of having fluid assets enough to pay its debts then due in the usual course of trade—without giving thought to the consequences. * * *"

The Questions Presented.

1. Did the Circuit Court of Appeals rightly decide by affirming the decree of the District Court that the petitioner's ancillary bill does not state facts constituting a cause of action and is without equity?

2. Did the Circuit Court of Appeals rightly decide that the District Court had jurisdiction over the subject matter in the primary cause?

3. May a Federal court of equity take jurisdiction and appoint receivers of a corporation which is solvent and able to pay and discharge in full, in cash, all its debts then due and maturing, merely because of the possibility that in the future the corporation may be unable to meet the debts which would then become due?

4. May a Federal court of equity take jurisdiction and appoint receivers of a corporation which is solvent and able to pay and discharge in full, in cash, all its debts then due and maturing, merely because the Board of Directors decides that it is desirable to reorganize it in order to scale its funded debt?

5. May a Federal court of equity take jurisdiction of a corporation which is solvent and able to pay in full, in cash, its debts presently due and maturing for the sole purpose of reorganizing it?

Reasons Relied on for the Allowance of the Writ.

A.

The exercise of jurisdiction in this cause is wholly without precedent and marks a departure from the accepted principles of law governing equity receiverships. It permits a going corporation which is solvent, liquid and amply able to meet and discharge its debts due and maturing, to evade its just obligations.

B.

The exercise of jurisdiction in this cause carries to the extreme the abuses so strongly condemned by this Court in Harkin vs. Brundage, 276 U. S., 36; Michigan vs. Michigan Trust Co., 286 U. S., 334; and Shapiro vs. Wilgus, 287 U. S., 348.

C.

The exercise of jurisdiction in this cause violates the fundamental rules of property and rights of creditors and constitutes a taking of property without due process of law, in violation of the Fifth Amendment of the Constitution of the United States.

Importance and Novelty of the Questions.

The questions involved in this cause are novel and in importance transcend the private interests of the petitioner. This Court has thrice warned against the perversion of the function of receivership and its use for the purpose of hindering and delaying creditors in the enforcement of their rights.

The legitimate functions of the remedy and the uses and extent to which it may be employed have never been definitely delimited by this Court. There is no doubt

that the doctrine in this case, unless reversed, will be widely applied and will be used as a precedent for the right of corporations to reorganize in order to scale their funded debts when, in the discretion of the board of directors, such a course is advisable.

The present case and the petition of Amy Arzt and Josephine Ramsey for a writ of certiorari which is being presented to this Court in the primary cause simultaneously herewith, place before this Court for the first time the whole subject of equity receiverships and their legitimate function.

We respectfully submit that it is of public importance that this Court should authoritatively and definitely define the uses, functions and limits of that remedy.

WHEREFORE, it is respectfully submitted that this petition for a writ of certiorari to review the decree of the Circuit Court of Appeals for the Third Circuit, should be granted.

LILY CLAPIER.

DAVID M. PALLEY,
of New York, N. Y.

CHARLES H. SACHS,
of Pittsburgh, Pa.,
of Counsel.

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Respondents
(*Appellees Below*).

BRIEF IN SUPPORT OF PETITION.

Opinions Below.

The opinion of the Circuit Court of Appeals for the Third Circuit is not yet reported; the opinion of Judge Gibson appears at page 79 of the record but has not been reported.

Jurisdiction.

The decree of the Circuit Court of Appeals was entered in the office of the Clerk of the Circuit Court for the Third Circuit on March 24th, 1933.

Jurisdiction to issue the writ is found in the provisions of Section 240-A of the Judicial Code as amended by the Act of February 13th, 1925.

Statement of Facts.

The principal facts are stated in the foregoing petition.

Specifications of Error.

1. The Circuit Court of Appeals erred in not reversing the decree of the District Court, dated May 31st, 1932, and in not vacating the decree and dismissing the bill of complaint in the primary cause as to the petitioner and all other creditors who did not assent to the plan of reorganization.

2. The Circuit Court of Appeals erred in holding that the jurisdiction over the subject matter in the primary cause existed and was properly exercised.

3. The Circuit Court of Appeals erred in holding that the exercise of jurisdiction in the primary cause did not constitute a taking of property without due process of law and in violation of the Fifth Amendment of the Constitution of the United States.

Argument.

I.

A Federal court of equity may not take jurisdiction, for the purpose of reorganizing it, of a corporation which is solvent and able to pay all its debts presently due and maturing, in full, in cash. The exercise of jurisdiction in such a case violates the fundamental principles of property and rights of creditors and consti-

tutes a taking of property without due process of law, in violation of the Fifth Amendment of the Constitution of the United States.

We have, in the brief submitted in support of the petition for a writ of certiorari presented to this court by Amy Arzt and Josephine Ramsey in the primary cause, set forth our theory of the fundamental principles governing creditors' suits in equity.

There exists an erroneous, but widely held belief, that diversity of citizenship in concatenation with the cabalistic formula, "multiplicity of suits, race of diligence, wasteful strife and controversy" vests in a Federal court of equity the power to reorganize corporations and effect under judicial sanction a fraudulent transfer of assets with a commutation of debts. That receivership in creditors' suits is distinctly an ancillary remedy for the enforcement of creditors' rights is being constantly overlooked and the results flowing from the exercise of that remedy have been mistaken for the remedy itself.

Through this misapprehension of the function and purpose of creditors' suits and the appointment of receivers therein, a remedy designed for the prevention of wrongs to creditors has been perverted into a means for the frustration of rights of creditors; and jurisdiction assumed to assure equitable distribution amongst creditors has, by transformation, been employed to bring about inequitable discrimination against creditors.

Indisputably, the primary cause was instituted for the purpose of effecting a reorganization of the National Radiator Corporation in accordance with the plan devised by the Reorganization Committee appointed by it.

It is apparent from even a superficial reading of the bill of complaint and the exhibits annexed thereto that the corporation was not insolvent nor threatened with immediate insolvency; that jurisdiction was invoked and receivers appointed to hold at bay debentureholders who refused to assent to the reorganization as planned and

demanded payment of the interest upon the debentures they held. It is also apparent that the corporation could have paid to the Reorganization Committee and to the other debentureholders, as well as to every other creditor, every claim then due out of the cash then in its possession. It is evident that not payment but prevention of payment, with the ultimate acquisition of the property, business and assets of the corporation free from the obligation to pay, was the real purpose of the suit.

No reason for the sale of the assets and the distribution of the proceeds was shown and none existed; the appeal was made to the court to employ its power of sale and distribution as a subterfuge in order to accomplish the transfer, to the National Radiator Corporation, disguised in the form of a new corporation, of all its business, property and assets as a going concern, absolved from the obligation to pay its debts to its non-assenting creditors.

The assumption and retention of jurisdiction in the primary cause was a departure from accepted principles of law and constituted a taking of property without due process of law, in violation of the Fifth Amendment of the Constitution of the United States.

Conclusion.

It is important that the questions and principles governing equity receiverships be authoritatively settled by this court.

Respectfully submitted,

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